UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

In re:

JOSEPH SCHAEFER AND LINDA
SCHAEFER,

Debtors.BKY 4-94-2124

MEMORANDUM ORDER

At Minneapolis, Minnesota, July 11, 1995.

The above-entitled matter came on for hearing before the undersigned on the 28th day of June, 1995 on a motion by the Debtors for disallowance of the claims of Coldwell Banker Nationwide Realty and Owen Reebie; and Burnet Realty and Michael Schomaker. Appearances were noted in the record.

FACTS

1. On August 5, 1994, the Debtors closed the sale of their home to Mark K. Thomas and Maureen A. Chevalier (collectively the "Buyers"). The Debtors' home was located at 14143 Shady Beach Trail, Prior Lake, Minnesota ("Property").

2. The Buyers were represented in the real estate transaction by Michael Schomaker ("Schomaker"), a real estate agent for Burnet Realty, Inc. ("Burnet"). The Debtors were represented by Skip Reebie ("Reebie"), a real estate agent for Coldwell Banker ("Coldwell") (collectively the "Claimants").

3. Schomaker first showed the Property to the Buyers in late February or early March, 1994. Following the initial showing, the Buyers directed Schomaker to make an offer on the Property. On March 7, 1994, Schomaker wrote up an offer pursuant to which the Buyers offered to purchase the Property for $460,000. The offer was accompanied by a Purchase Agreement.

4. The Debtors declined the Buyers' offer and made an oral counteroffer. The Buyers rejected the Debtors' counteroffer. Following the unsuccessful exchange of offers, discussions between the Debtors and Buyers ceased.

5. On April 26, 1994, Debtors filed a voluntary petition for relief under Chapter 11 of the Code.

6. In early May, 1994, Schomaker received a call from the Buyers regarding the Property. They had decided that they wanted to look at the Property again. On May 10, 1994, Schomaker went with the Buyers to the Property where they were met by the Debtors and Reebie. At that time, the Debtors accompanied the Buyers on a thorough walk-through of the Property.

7. Following this walk-through, on May 10, 1994, the Buyers made a new offer to purchase the Property for $524,000. The Buyers made this offer on the same Purchase Agreement used for the prior offer; they just scribbled out the earlier offer and inserted and initialed the new offer.

8. The Debtors accepted the new offer on May 11, 1994. When the Debtors signed the Purchase Agreement, they added the requirement that the sale was subject to bankruptcy court approval. Schomaker then returned the Purchase Agreement to the Buyers so they could consider this additional condition to

the sale.

9. On May 12, 1994, the Buyers accepted this additional condition by initialing the clause. Accordingly, the final acceptance date of the Purchase Agreement was May 12, 1994. Prior to this date, there was no final agreement between the Buyers and the Debtors regarding the sale of the Property.

10. At the time the Buyers and the Debtors signed the Purchase Agreement, they also agreed to arbitrate any dispute which arose regarding the physical condition of the Property pursuant to the rules adopted by the American Arbitration Association. In addition, they agreed to arbitrate the dispute within the following time period:

A request for arbitration must be filed within six (6) months of the date on which relevant facts about the claim were, or reasonably could have been, discovered or else the claim cannot be pursued.

11. By amended order dated August 3, 1994, this Court granted Debtors' motion authorizing Debtors to sell the Property under Section 363 of the Code. On August the Property under Secion 363 of the code. On August 5, 1994 --over three months after the Debtors filed for bankruptcy relief--the Debtors and the Buyers closed the sale of the Property.

bankruptcy case was August 11, 1994.

13. On January 10, 1995, the Buyers served a Demand for Arbitration on the Debtors, Reebie, Coldwell, Schomaker and Burnet. The Demand for Arbitration alleges that, in connection with the sale of the Property, the Debtors and Reebie fraudulently misrepresented to the Buyers that the Property was "[l]akefront" and "[t]ruly the ultimate lakeshore property." The Demand for Arbitration further alleges that these statements were fraudulent because the Property has only deeded access to the lake. The Demand for Arbitration also alleges that Schomaker was negligent in the performance of his duties as the Buyers' agent because he "knew or should have known that the shoreline was not included in the sale of the Property to [the Buyers]." The Demand for Arbitration asserted claims against Burnet and Coldwell under a theory of vicarious liability.

14. The Buyers' Demand for Arbitration seeks damages against all named defendants on a joint and several basis in the amount of $214,300 based on the alleged reduced value of the Property because it does not have the exclusive right to the lake front.

15. Following service of the Demand for Arbitration, the Buyers withdrew their claims against the Debtors in the arbitration proceeding because of the automatic stay.

16. The Claimants believe that to the extent that they are liable to the Buyers in the arbitration proceeding based on the Buyers' claim of negligence, they have a claim against the Debtors based on the Debtors' fraud either under a theory of direct tort liability, indemnification or contribution. Accordingly, the Claimants sought and obtained an Order from this Court granting them relief from the automatic stay so that they could liquidate their claims against the Debtors in the arbitration proceeding.

17. On May 10, 1995, Burnet and Schomaker asserted a crossclaim in the arbitration. The arbitration proceeding is currently pending.

18. Subsequent to the Claimants receiving relief from

the automatic stay, the Debtors filed the motion seeking to disallow the Claimants' claims on three bases: (i) the Claimants did not timely file a proof of claim; (ii) the Claimants' claims are barred by an agreed-upon limitations period set forth in the Arbitration Agreement; and (iii) the Claimants' claims are contingent and should be disallowed under Section 502(c)(1) of the Code. The Claimants oppose the motion, arguing that their claims are postpetition claims that are entitled to administrative expense priority.

DISCUSSION

A. The Claimants' Claims Arose Postpetition and Thus They Did Not Need to File a Proof of Claim

The Debtors first assert that the Claimants' claims are barred because they did not file a proof of claim by August 11, 1994. Section 501 of the Code provides that a "creditor . . . may file a proof of claim." 11 U.S.C. Section 501(a). Federal Rule of Bankruptcy Procedure 3003(c) provides that "[a]ny creditor . . . whose claim or interest is not scheduled shall file a proof of claim . . .." Fed. R. Bankr. P. 3003(c)(2). The Bankruptcy Code defines "creditor" as an "entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor."

11 U.S.C. Section 101(10)(A) (emphasis added).

In United States v. Union Scrap Iron & Metal, 123 B.R. 831 (D. Minn. 1990), the court stated:

> nonbankruptcy substantive law defines when a particular relationship between a debtor and a third party amounts to a legal obligation reflecting a claim for bankruptcy purposes. A claim exists only when the prebankruptcy relationship between the debtor and the third-party contained all the elements necessary to give rise to a legal obligation under the relevant substantive nonbankruptcy law.

Id. at 835 (citing In re Remington Rand Corp., 836 F.2d 825, 830 (3d Cir. 1988); In re UNR Indus., Inc., 29 B.R. 741, 745-46 n.4 (N.D. Ill. 1983)).

Here, the Claimants' claims are based on the alleged fraud of the Debtors in connection with the sale of the Property. Under Minnesota law, a fraud claim requires a claimant to establish not only a misrepresentation but reliance thereon and damages resulting therefrom. See, e.g., M.H. v. Caritas Family Servs., 488 N.W.2d 282, 289 (Minn. 1992). The Buyers and the Debtors did not sign the completed Purchase Agreement until May 12, 1994--after the Debtors' bankruptcy filing. The Buyers and the Debtors did not close the sale of the Property until August 5, 1994--more than three months after the Debtors' bankruptcy filing. Until the Buyers purchased the Property (or, at the very least, agreed to purchase the Property by signing the Purchase Agreement), there was no reliance by the Buyers on the Debtors' misrepresentations. Thus no prepetition claim of fraud exists. See Lemelle v. Universal Mfg. Corp., 18 F.3d 1268, 1277-78 (5th Cir. 1994); Pettibone Corp. v. Ramirez (In re Pettibone Corp.), 90 B.R. 918, 932-33 (Bankr. N.D. Ill. 1988).

This result is distinguishable from the line of cases which hold that a claim may arise prepetition for bankruptcy purposes even though the injury does not manifest itself until after the bankruptcy filing. For example, in Grady v. A.H.

Robins Co., Inc., 839 F.2d 198 (4th Cir. 1988), the Fourth Circuit held that a claim for damages caused by the Dalkon Shield was a prepetition claim. The court stated that the claim existed "when the Dalkon Shield was inserted in the claimant prior to the time of filing of the petition." Id. at 203. Unlike Robins, there was no tortious consequence arising from the Debtors' conduct until the Buyers relied on the alleged misrepresentations when they signed the Purchase Agreement postpetition. If the Buyers had purchased the property prepetition but did not discover until after the bankruptcy filing that the Property was not lake front, the claims of fraud arising from the sale arguably would be prepetition. Yet, that is not the case here. Because the Claimants' claims against the Debtors arose postpetition, the Claimants were not required to file a proof of claim in the Debtors' bankruptcy case. Accordingly, the Debtors' first basis for seeking disallowance of the Claimants' claims is without merit.

B. The Claimants' Claims Are Not Barred by Agreement of the Parties

The Debtors argue, in the alternative, that the Claimants' claims should be disallowed under Section 502(d) because the claims were not asserted within the six-month time period provided for in the Arbitration Agreement. This argument does not constitute a valid basis for disallowing the Claimants' claims.

This Court granted the Claimants relief from the automatic stay to allow the Claimants to liquidate their claims against Debtors in the arbitration proceeding. In that proceeding, the Debtors will have the opportunity to raise defenses to the Claimants' claims, including a defense based on the foregoing provision of the Arbitration Agreement. The arbitration panel is the appropriate entity to interpret the meaning of the Arbitration Agreement. Accordingly, this is not a basis for seeking disallowance of the claims.

C. The Claimants' Claims Should Not Be Disallowed Under Section 502(e)(1)

Finally, the Debtors argue that the Claimants' claims should be disallowed based on Section 502(e)(1). This provision provides that:

> the court shall disallow any claim for reimbursement or contribution of an entity that is liable with the debtor on . . . the claim of a creditor, to the extent that--
>
> (A) such creditor's claim against the estate is disallowed;
>
> (B) such claim for reimbursement or contribution is contingent as of the time ofallowance or disallowance of such claim forreimbursement or contribution; or
>
> (C) such entity asserts a right of subrogation to the rights of such creditor under section 505 of this title.

11 U.S.C. Section 502(e)(1). This provision is not

applicable to the Claimants' claims. This provision requires that the Claimants be "liable with the debtor on . . . the claim of a creditor." The Debtors' motion does not address this requirement. Presumably, the entity which the Debtors believe is the "creditor" are the Buyers. However, a "creditor" is defined as an entity having a claim against the Debtors which arose prior to the bankruptcy filing. As discussed above, the Buyers' claim of fraud against the Debtors is a postpetition and not a prepetition claim. Accordingly, this provision does not apply to the Claimants' claim against the Debtors and does not serve as a basis for disallowance.

CONCLUSION

ACCORDINGLY IT IS HEREBY ORDERED THAT:

1. The Debtors' motion seeking disallowance of the claim of Burnet and Schomaker is OVERRULED;

2. The Debtors' motion seeking disallowance of the claim of Reebie and Coldwell is OVERRULED;

3. Allowance of the claims shall be consistent with the limits of the arbitration proceeding; and

4. The treatment of the claims, if any, shall be reserved in a later proceeding.

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Nancy C. Dreher
United States Bankruptcy Judge